

To: Transport Industry Operators

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Ref : Chans advice/30

ISM Code Compliance Warranty

On 10/6/2003 Judge William Stone of the High Court of the Hong Kong Special Administrative Region held a cargo underwriter liable to pay compensation in the sum of US\$915,121.3 plus costs and interest to the cargo owners under three marine cargo insurance policies.

On 26/11/2000 the general cargo vessel "Rui Xiang" sank with all her goods whilst on a voyage from Labuan, Malaysia to Nansha, China. The goods which sank with her included 807 Indonesian round logs shipped under four bills of lading.

The three marine cargo policies covering the 807 logs were expressly subject to the ICC(C), which provides that the risks covered shall cover "loss or damage to the subject matter insured reasonably attributable to ... vessel or craft being stranded grounded sunk or capsized." There is no dispute that the loss of the logs was attributable to the sinking of the "Rui Xiang". However, the cargo underwriter declined to make payment under the policies on the basis that there was a breach of warranty appearing on the face of all three policies, which read: "Warranted the carrying vessels must be ISM Code compliance".

The ISM Code – to give it its full title "The International Management Code for the Safe Operation of Ships and for Pollution Prevention" – has international effect by virtue of amendments adopted in 1994 to the International Convention for the Safety of Life at Sea 1974, and comes under the auspices of the International Maritime Organisation. The Code requires shipowners and managers of vessels to which the Code applies to maintain management systems to ensure safety of life at sea, and avoidance of damage to the environment and to property, and makes provision for a document of compliance to be issued by the Government of the State whose flag the particular vessel flies. Important in the context of this case are the compliance dates: on 1 July 1998 compliance with the ISM Code became mandatory for tankers, bulk carriers, gas carriers, passenger ships and cargo high-speed craft of 500 gross tonnes and above, but in November 2000 compliance was *not* mandatory for general cargo vessels such as the "Rui Xiang", only becoming mandatory for general cargo vessels of 500 gross tonnes or more on 1 July 2002.

There was a Open Cover policy issued by the cargo underwriter to the cargo owners insuring various types of timber, including logs, shipped from Malaysia or Indonesia to China. It was a condition of the contract that the Assured was bound to declare every consignment without exception, which in turn the Underwriter was bound to accept subject to a maximum limit of US\$1.5 million to the value of the goods to be shipped on any one vessel. The Open Cover contained the following: "For bulk carrier only: Warranted the carrying vessels must be ISM Code compliance".

On 18/11/2000 the assured notified the underwriter of an intended shipment of Indonesian round logs to the value of about US\$1,056,000 on board the vessel "Rui Xiang" for carriage from Labuan Port, Malaysia to Nansha, China. The notification bore the legend: "Kindly issue cover note as follows: ". On 23/11/2000 the assured referred to the Cover Note and requested the underwriter to issue "3 sets policies as follows:". These policies were issued in the terms requested.

On or before 21/11/2000 the consignments of logs commenced their transit. The vessel sank on 26/11/2000. The cargo owners gave notice of claims to the underwriter on 27/11/2000. On 5/7/2001, the cargo underwriter declined the claims on the basis of the alleged breach of the ISM Code warranty in the policies. No document had been provided showing that the vessel complied with the ISM Code.

The insurer submitted that the three policies were free-standing policies which fell "outwith" the umbrella of the Open Cover. The insurer could "go along" with the insured's request for a Cover Note, which could be regarded as an offer to enter into an insurance contract outside the existing Open Cover framework. Such an offer was accepted by the act of actually issuing the cover note.

However, the Judge firmly rejected the thesis that because the faxes of 18 and 23 November made no reference to the Open Cover, and because the first fax made reference to a "cover note", that these faxes thereby should be

regarded as constituting an application for insurance wholly separate from the Open Cover that was in place. The Judge saw no reason whatever why the fax of 18/11/2000 could not be regarded as a relevant declaration under the Open Cover. To construe the fax as being a request for insurance “outwith” the Open Cover in effect would be to construe it as a request for double insurance with the same underwriter, which would be a “commercial nonsense”. Accordingly, the Judge found in favour of the cargo owners’ argument that the policies were under the Open Cover.

The Judge further added that if he was wrong in holding that the policies were under the Open Cover, he would have regarded favourably the cargo owners’ primary alternative submission that the terms of the warranty appearing on the face of these policies, with its emphasis upon “compliance”, lent itself to the commercially-sensible construction whereby this particular warranty was applicable to those vessels for which compliance with the ISM Code was mandatory, but not otherwise. The term “compliance” connotes obedience to applicable extrinsic rule, and that absent any such internationally – sanctioned requirement of obedience to this Code, a general cargo vessel such as the “Rui Xiang” should not to be regarded as being in a state of “non-compliance” with the ISM Code. This term was expressed as a warranty, which under section 33 of the Marine Insurance Act is a condition requiring exact compliance, whether or not material to the risk. The Court should be astute not to construe this warranty in a way which does damage to its clear commercial purport, and the manner in which it would be understood by commercial men. Indeed it was the clear understanding between the commercial parties in the instant case that the ISM Code warranty was to have no application to general cargo vessels, which at that time accurately represented the position in terms of the international applicability of the ISM Code.

To protect your interests, we recommend you pay more attention to the warranties contained in insurance policies. Should you have any questions or want to have a copy of the Judgment, please feel free to contact us.

Simon Chan and Richard Chan



A normal claim cycle is like the following:-

Cargo damaged/lost. Potential claim is imminent.

Worry starts. Where does the company stand? What should be the most appropriate next step? Is a survey required? What surveyor? How to respond to a claim notification from client? **Should the claim be reported to my insurer?** What documents to gather? What are the key aspects to look for to protect the company’s interest? Could I pass the ball down the line? Do I forget to hold someone responsible? Should a time extension be granted? What should be an appropriate claim handling strategy? Who monitors the claim progress? Who does the co-ordination with my insurer ensuring the company’s interests is not prejudiced? **When would the company get reimbursed for a valid claim?**

Report the claims to Sun Hing and you are worry free. Your Claims Handling could never be easier!

Professional risk management consultants take care of your worry and trouble (deleted above) in case of a claim, even if you do not carry liability insurance - Feel Free to discuss your needs with Simon or Richard.